

**REPORT OF THE AUDIT OF THE
FORMER HARLAN COUNTY
SHERIFF**

**For The Year Ended
December 31, 2005**



**CRIT LUALLEN
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EXECUTIVE SUMMARY

AUDIT EXAMINATION OF THE FORMER HARLAN COUNTY SHERIFF

**For The Year Ended
December 31, 2005**

The Auditor of Public Accounts has completed the former Harlan County Sheriff's audit for the year ended December 31, 2005. Based upon the audit work performed, the financial statement presents fairly, in all material respects, the revenues, expenditures, and excess fees in conformity with the regulatory basis of accounting.

Financial Condition:

Excess fees increased by \$73,204 from the prior year, resulting in excess fees of \$854,869 as of December 31, 2005. Revenues increased by \$81,476 from the prior year and expenditures increased by \$8,272.

Report Comments:

- The Former Sheriff Should Not Have Expended Drug Forfeiture Funds As A Donation Or Gift
- The Former Sheriff's Office Lacked Adequate Segregation Of Duties

Deposits:

The former Sheriff's deposits were insured and collateralized by bank securities.

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Joseph A. Grieshop, Harlan County Judge/Executive
Honorable Steve Duff, Former Harlan County Sheriff
Honorable Marvin J. Lipford, Harlan County Sheriff
Members of the Harlan County Fiscal Court

Independent Auditor's Report

We have audited the accompanying statement of revenues, expenditures, and excess fees - regulatory basis of the former Sheriff of Harlan County, Kentucky, for the year ended December 31, 2005. This financial statement is the responsibility of the Sheriff. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for County Fee Officials issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the Sheriff's office prepares the financial statement on a regulatory basis of accounting that demonstrates compliance with the laws of Kentucky, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the revenues, expenditures, and excess fees of the former Sheriff for the year ended December 31, 2005, in conformity with the regulatory basis of accounting described in Note 1.

In accordance with Government Auditing Standards, we have also issued our report dated July 30, 2007 on our consideration of the former Sheriff's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.



The Honorable Joseph A. Grieshop, Harlan County Judge/Executive
Honorable Steve Duff, Former Harlan County Sheriff
Honorable Marvin J. Lipford, Harlan County Sheriff
Members of the Harlan County Fiscal Court

Based on the results of our audit, we have presented the accompanying comments and recommendations, included herein, which discuss the following report comments:

- The Former Sheriff Should Not Have Expended Drug Forfeiture Funds As A Donation Or Gift
- The Former Sheriff's Office Lacked Adequate Segregation of Duties

This report is intended solely for the information and use of the former Sheriff and Fiscal Court of Harlan County, Kentucky, and the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these interested parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen
Auditor of Public Accounts

July 30, 2007

HARLAN COUNTY
STEVE DUFF, FORMER SHERIFF
MARVIN J. LIPFORD, SHERIFF
STATEMENT OF REVENUES, EXPENDITURES, AND EXCESS FEES - REGULATORY BASIS

For The Year Ended December 31, 2005

Revenues

Federal Grants

Corps of Engineers	\$ 5,700		
High Intensity Drug Trafficking Area (HIDTA)	45,514	\$	51,214

State Fees For Services:

Finance and Administration Cabinet	121,174		
Cabinet For Health and Family Services	3,320		124,494

Fiscal Court			79,846
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County Clerk - Delinquent Taxes			6,475
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Commission On Taxes Collected			546,229
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Fees Collected For Services:

Auto Inspections	11,195		
Accident and Police Reports	6		
Serving Papers	31,250		
Conveying Prisoners	11,384		
Executions	3,720		
Carrying Concealed Deadly Weapon Permits	15,270		72,825

Other:

Sheriff's Cost and Advertising	6,997		
Sheriff's Add-On Fees	43,071		
Fuel Refund	13,676		
Miscellaneous	383		64,127

Interest Earned			9,335
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Total Revenues			954,545
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The accompanying notes are an integral part of this financial statement.

HARLAN COUNTY
STEVE DUFF, FORMER SHERIFF
MARVIN J. LIPFORD, SHERIFF
STATEMENT OF REVENUES, EXPENDITURES, AND EXCESS FEES - REGULATORY BASIS
For The Year Ended December 31, 2005
(Continued)

Expenditures

Operating Expenditures:

Other Charges-

Conventions and Travel	\$	867
Postage		1,221
Carrying Concealed Deadly Weapon Permits		11,285
Miscellaneous		2,711
Bank Charges		111
Executions		<u>3,635</u>

Total Expenditures		<u>\$</u>	<u>19,830</u>
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Net Revenues			934,715
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Less: Statutory Maximum	76,652		
Training Incentive Benefit	<u>3,194</u>		<u>79,846</u>

Excess Fees Due County for 2005			854,869
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Payments to County Treasurer - Monthly During the Year			<u>854,869</u>
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Balance Due Fiscal Court at Completion of Audit		<u>\$</u>	<u>0</u>
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The accompanying notes are an integral part of this financial statement.

HARLAN COUNTY
NOTES TO FINANCIAL STATEMENT

December 31, 2005

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

A fee official uses a fund to report on the results of operations. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fee official uses a fund for fees to account for activities for which the government desires periodic determination of the excess of revenues over expenditures to facilitate management control, accountability, and compliance with laws.

B. Basis of Accounting

KRS 64.820 directs the fiscal court to collect any amount, including excess fees, due from the Sheriff as determined by the audit. KRS 134.310 requires the Sheriff to settle excess fees with the fiscal court at the time he files his final settlement with the fiscal court.

The financial statement has been prepared on a regulatory basis of accounting, which demonstrates compliance with the laws of Kentucky and is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this regulatory basis of accounting revenues and expenditures are generally recognized when cash is received or disbursed with the exception of accrual of the following items (not all-inclusive) at December 31 that may be included in the excess fees calculation:

- Interest receivable
- Collection on accounts due from others for 2005 services
- Reimbursements for 2005 activities
- Tax commissions due from December tax collections
- Payments due other governmental entities for payroll
- Payments due vendors for goods or services provided in 2005

The measurement focus of a fee official is upon excess fees. Remittance of excess fees is due to the County Treasurer in the subsequent year.

C. Cash and Investments

At the direction of the fiscal court, KRS 66.480 authorizes the Sheriff's office to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

HARLAN COUNTY
NOTES TO FINANCIAL STATEMENT
December 31, 2005
(Continued)

D. Fee Pooling

The Harlan County Fiscal Court approved a fee pooling system for the Harlan County Sheriff. Under the fee pooling system, revenues net of direct expenses of the County Sheriff's Office are paid to the Harlan County Treasurer in the subsequent month. Therefore, the County pays almost all of the expenses of the Harlan County Sheriff's Office.

Note 2. Employee Retirement System

The county officials and employees have elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost-sharing, multiple-employer, defined benefit pension plan that covers all eligible full-time employees and provides for retirement, disability, and death benefits to plan members.

Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5.0 percent of their salary to the plan. The county's contribution rate for nonhazardous employees was 8.48 percent for the first six months and 10.98 percent for the last six months of the year.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65.

Historical trend information pertaining to CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report which is a matter of public record. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, Kentucky 40601-6124, or by telephone at (502) 564-4646.

Note 3. Deposits

The former Sheriff maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) as required by KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the Sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the Sheriff's deposits may not be returned. The former Sheriff did not have a deposit policy for custodial credit risk but followed the requirements of KRS 41.240(4). As of December 31, 2005, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

HARLAN COUNTY
NOTES TO FINANCIAL STATEMENT
December 31, 2005
(Continued)

Note 4. Drug Account

The Sheriff's office maintained a drug account during 2005. The drug account had a beginning balance of \$67,226 as of January 1, 2005. Receipts during the year were \$86,728 including \$1,746 in interest income. Disbursements during the year totaled \$31,284, resulting in an ending cash balance of \$122,670 at December 31, 2005. This amount was transferred to the incoming Sheriff.

Note 5. HIDTA Sub-Grant

The former Harlan County Sheriff entered into a sub-grant agreement with Appalachia HIDTA on April 27, 2004. The purpose of the sub-grant was to provide funding for an investigation officer for the Harlan County Sheriff's office. The former Sheriff received \$45,514 during 2005 under the sub-grant agreement.

Note 6. Subsequent Event

On November 17, 2006, the former Harlan County Sheriff donated \$71,697 to the City of Evarts. On November 27, 2006, the former Sheriff donated \$7,300 to the City of Evarts. These funds were paid out of the Drug Forfeiture account, which is a restricted account pursuant to KRS 218A.435(12). The City of Evarts returned the full amount to the Harlan County Sheriff's office in separate checks totaling \$78,997 in February 2007.

COMMENTS AND RECOMMENDATIONS

HARLAN COUNTY
STEVE DUFF, FORMER SHERIFF
COMMENTS AND RECOMMENDATIONS

For The Year Ended December 31, 2005

STATE LAWS AND REGULATIONS:

The Former Sheriff Should Not Have Expended Drug Forfeiture Funds As A Donation Or Gift

On November 17, 2006, the former Harlan County Sheriff donated \$71,697 to the City of Evarts. On November 27, 2006, the former Sheriff donated \$7,300 to the City of Evarts. These funds were paid out of the Drug Forfeiture account. Pursuant to KRS 218A.435(12) the Drug Forfeiture funds shall be paid to or retained by the law enforcement agency or agencies which seized the property forfeited, to be used for direct law enforcement purposes. Further, KRS 218A.435(12) establishes a mandatory distribution scheme regarding funds forfeited pursuant to KRS Chapter 218A, and restricts the use of such funds. The City of Evarts returned the full amount to the Harlan County Sheriff's office in separate checks totaling \$78,997 in February 2007. We conclude that the former Sheriff should not have expended Drug Forfeiture funds as a donation or gift, pursuant to KRS 218A.435(12).

The former Harlan County Sheriff gifted away \$5,000 of Drug Forfeiture funds to the City Of Evarts that were not returned to the Sheriff. He contends that the transfer of these funds was allowable under federal forfeiture guidelines. We recommend the Sheriff consult with his County Attorney as to the legality of this transfer.

Former Sheriff's Response: These funds were given to the Evarts Police Department, a law enforcement agency – not for the City of Evarts General Fund. These funds were given for law enforcement purposes to a law enforcement agency.

INTERNAL CONTROL - REPORTABLE CONDITION AND MATERIAL WEAKNESS:

The Former Sheriff's Office Lacked Adequate Segregation Of Duties

The former Sheriff's internal control structure lacked adequate segregation of duties. There was a limited staff size, which prevented adequate division of responsibilities. The former Sheriff had statutory authority to assume the role of custodian of monetary assets, as well as recorder of transactions and preparer of financial statements. However, having one person solely responsible for these duties compromised the internal control structure of the sheriff's office. Having only one individual who is responsible for all duties increases the risk that misstatements or errors may occur and not be detected in a timely manner. The former Sheriff should have implemented the following compensating controls to help offset the lack of adequate segregation of duties:

- The former Sheriff should have recorded and deposited daily receipts.
- The former Sheriff should have conducted surprise cash counts.
- Reconciliation of reports to source documents and receipts and disbursements ledger by the Sheriff.
- The former Sheriff should have reconciled reports to source documents and to the receipts and disbursements ledgers.
- The former Sheriff should have required employees to take vacations.
- The former Sheriff should have prepared bank reconciliations.

Former Sheriff's Response: When the State provides the resources we will be able to do this.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL
STATEMENT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Joseph A. Grieshop, Harlan County Judge/Executive
Honorable Steve Duff, Former Harlan County Sheriff
Honorable Marvin J. Lipford, Harlan County Sheriff
Members of the Harlan County Fiscal Court

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards

We have audited the statement of revenues, expenditures, and excess fees - regulatory basis of the former Harlan County Sheriff for the year ended December 31, 2005, and have issued our report thereon dated July 30, 2007. The former Sheriff's financial statement is prepared in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the former Harlan County Sheriff's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statement. A reportable condition is described in the accompanying comments and recommendations.

- The Former Sheriff's Office Lacked Adequate Segregation Of Duties

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition described above to be a material weakness.



Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards
(Continued)

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the former Harlan County Sheriff's financial statement for the year ended December 31, 2005, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under Government Auditing Standards and which is described in the accompanying comments and recommendations.

- The Former Sheriff Should Not Have Expended Drug Forfeiture Funds As A Donation Or Gift

This report is intended solely for the information and use of management, the Harlan County Fiscal Court, and the Kentucky Governor's Office for Local Development and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

July 30, 2007

